

(c) *Compliance with guidelines.* It is strongly encouraged, but not required, that all such properties be tested in accordance with the Lead-Based Paint Interim Guidelines for Hazard Identification and Abatement in Public and Indian Housing (hereafter Lead-Based Paint Interim Guidelines), as periodically amended or updated, and other future official departmental issuances related to lead-based paint, before any irrevocable commitment is made to acquire the property. The Lead-Based Paint Interim Guidelines are available by contacting the following office: Department of Housing and Urban Development, Office of Lead-Based Paint Abatement and Poisoning Prevention, Room B-133, 451 Seventh Street, SW, Washington, DC 20410; telephone (202) 755-1805. Properties that have already been tested in accordance with the Lead-Based Paint Poisoning Prevention Act as amended by the Housing and Community Development Act of 1987 need not be tested again. If lead-based paint is found in a property to be acquired, the cost of testing and abatement shall be considered when making the cost comparison to justify new construction, as well as when meeting maximum total development cost limitations.

\* \* \* \* \*

10. On page 18237, in column three, § 950.570 is corrected by revising paragraph (c), to read as follows:

**§ 950.570 Procedures involving EBLs.**

\* \* \* \* \*

(c) *Testing.* Testing shall be completed within five days after notification to the IHA of the identification of the EBL child. It is strongly recommended, but not required, that IHAs use the testing methods outlined in Part II of the Lead-Based Paint Interim Guidelines, as periodically amended or updated, and other future official departmental issuances related to lead-based paint. A qualified inspector or laboratory shall certify in writing the precise results of the inspection. Testing services available from State, local, or tribal health or housing agencies or an organization recognized by HUD shall be utilized to the extent available. If the results equal or exceed a level of 1 mg/cm<sup>2</sup> or .5% by weight, the results shall be provided to the tenant or the family of the EBL child using the IHA-owned or operated child care facility. Testing will be considered an eligible modernization cost under subpart I of this part only upon IHA certification

that testing services are otherwise unavailable.

\* \* \* \* \*

Dated: June 28, 1995.

**Michael B. Janis,**

*General Deputy Assistant Secretary for Public and Indian Housing.*

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## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[T.D. 8228]

#### Allocation and Apportionment of Interest Expense

##### *CFR Correction*

In title 26 of the Code of Federal Regulations, part 1, §§ 1.851 to 1.907, revised as of April 1, 1995, on page 140, § 1.861-8(e)(2) is corrected to read as follows:

##### **§ 1.861-8 Computation of taxable income from sources inside the United States and from other sources and activities.**

\* \* \* \* \*

(e) *Allocation and apportionment of certain deductions.*

\* \* \* \* \*

(2) *Interest.* [Reserved] For guidance, see § 1.861-8T(e)(2).

\* \* \* \* \*

BILLING CODE 1505-01-D

#### 26 CFR Part 1

[TD 8598]

RIN 1545-AT50

#### Consolidated Groups—Intercompany Transactions and Related Rules

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Temporary regulations.

**SUMMARY:** This document contains temporary regulations that provide rules for disallowing loss and excluding gain for certain dispositions and other transactions involving stock of the common parent of a consolidated group. These temporary regulations are necessary to prevent taxpayers from recognizing certain gains and losses on common parent stock that would not be recognized if a consolidated group were treated as a single entity. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed

rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register**.

**DATES:** These regulations are effective July 12, 1995.

For dates of applicability, see the effective date provision of the temporary regulations.

**FOR FURTHER INFORMATION CONTACT:** Victor Penico, (202) 622-7750 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### **Background**

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 1502. These temporary regulations provide rules for disallowing loss and excluding gain for certain dispositions and other transactions involving stock of the common parent of a consolidated group.

Final regulations published in this issue of the **Federal Register** provide rules for the treatment of intercompany transactions. The regulations generally provide greater single entity treatment of intercompany transactions than prior regulations under §§ 1.1502-13 and -14.

For intercompany transactions with respect to stock of a member, however, the final regulations generally adopt separate entity treatment, similar to the treatment under prior § 1.1502-14. For example, stock is generally treated as an asset separate from the member's underlying assets and, if a member's stock is sold in an intercompany transaction, gain or loss from the stock sale is taken into account under the matching and acceleration rules that apply to other assets. The regulations adopt this approach in part because greater single entity treatment would significantly increase the complexity of the regulations. See Notice 94-49, 1994-18 I.R.B. 8, for a discussion of issues relating to the single entity treatment of stock.

The Treasury and the IRS are continuing to study whether greater single entity treatment of stock is appropriate or possible. While finalizing the intercompany transaction regulations, however, the Treasury and the IRS have become aware that consolidated groups are relying on the separate entity treatment of stock to claim losses on capital raising and other transactions. For example, taxpayers might seek to take advantage of separate entity treatment by having a subsidiary (S) purchase the stock of the common parent (P) from P. If the value of the P stock has gone down at a time when the group wants to issue P stock, S will sell its P stock at a loss and claim the losses, even though in a sale of the stock by P,

no gain or loss would be recognized under section 1032.

Although the circular ownership described in this structure could result in the recognition of gains as well as losses on the sale of P stock, taxpayers can easily avoid most gains. For example, if the P stock held by S appreciates, P can issue P stock and avoid recognizing gain under section 1032. Other transactions involving circular ownership are subject to specific relief. See, for example, Rev. Rul. 80-76, 1980-1 C.B. 15 (no gain on S's use of P stock to compensate S's employee); Prop. Reg. § 1.1032-2(b) (no gain or loss on S's use of certain P stock in triangular reorganizations).

Through planning techniques and relief provisions, taxpayers may use circular ownership structures to claim artificial losses and to avoid reporting of gains. As a result, taxpayers frequently have the benefit of single entity treatment for gains but separate entity treatment for losses. The Treasury and the IRS have concluded, therefore, that pending further study of single entity treatment of stock generally, temporary regulations are necessary to provide greater single entity treatment for losses by preventing groups from inappropriately claiming losses on the sale of stock of the common parent.

As mentioned above, in transactions where S intends to use P stock for a legitimate business purpose, S can generally avoid the recognition of gain. Nonetheless, structuring transactions to avoid the gain adds additional costs and uncertainties to these transactions. Therefore, these temporary regulations also include provisions to prevent taxpayers from being subject to inappropriate taxation on gains in certain transactions.

### Explanation of Provisions

These temporary regulations are limited to transactions involving P stock. While similar artificial losses or gains may arise in transactions involving circular ownership with respect to the stock of a subsidiary, existing regulations address many issues with respect to losses in S stock. See § 1.1502-20. For purposes of these temporary regulations, P stock is any stock of the common parent held by another member, or any stock of a member (the issuer) that was the common parent if the stock was held by another member while the issuer was the common parent.

These temporary regulations provide that losses recognized with respect to P stock held by a member are permanently disallowed. Similarly, if a member, M, owns P stock, the stock is subsequently

owned by a nonmember, and immediately before the stock is owned by the nonmember M's basis in the share exceeds its fair market value, then (unless the loss is disallowed under the general rule) M's basis in the share is reduced immediately before the share is held by the nonmember. For example, if M owns shares of P stock with a basis in excess of their fair market value and M becomes a nonmember, M's basis in the P shares is reduced to fair market value immediately before M becomes a nonmember. Similar principles apply to options and other positions with respect to P stock.

To qualify for the relief from gain, the member must acquire P stock directly from P through a contribution to capital or a transaction qualifying under section 351(a), and must, pursuant to a plan, transfer the stock immediately to an unrelated nonmember in a taxable transaction (other than in exchange for P stock). In addition, the common parent must remain the common parent and the member must remain a member.

These temporary regulations provide relief from gain by providing S with a fair market value basis in the P stock. To properly reflect the transaction in the basis of other members, (including P's basis in its S stock) these regulations treat S as if it purchased the stock from P with cash contributed by P. No inference is intended whether circular cash flows would be respected apart from this regulation. Similarly, no inference is intended with respect to other methods of avoiding gain on S's use of P stock.

The Treasury and the IRS request comments as to transactions outside the scope of the regulations. In particular, comments are requested as to whether any such transactions should be given relief from gain recognition. In addition, comments are requested on whether greater single entity treatment of stock should be adopted more generally.

These temporary regulations are effective for transactions on or after the date they are filed with the **Federal Register**.

### Special Analysis

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations only affect affiliated groups of corporations that have elected to file consolidated returns, which tend to be larger businesses. The

rules do not significantly alter the reporting or recordkeeping duties of small entities. Accordingly, a regulatory flexibility analysis is not required. It has also been determined that under section 553(d) of the Administrative Procedure Act (5 U.S.C. chapter 5) there is good cause for these regulations to be effective immediately to insure transactions in P stock are appropriately reflected. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

### Drafting Information

These regulations were drafted by personnel from the Treasury Department and the IRS.

### List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

### PART 1—INCOME TAXES

**Paragraph 1.** The authority citation for part 1 continues to read in part as follows:

**Authority:** 26 U.S.C. 7805 \* \* \* Section 1.1502-13T also issued under 26 U.S.C. 1502 \* \* \*

**Par. 2.** Section 1.1502-13T is added to read as follows:

#### § 1.1502-13T Intercompany transactions temporary.

(a) through (f)(5) [Reserved] For further guidance, see 1.1502-13.

(f)(6) *Stock of common parent.* In addition to the general rules of this section, this paragraph (f)(6) applies to parent stock (P stock) and positions in parent stock held by another member. For this purpose, P stock is any stock of the common parent held by another member or any stock of a member (the issuer) that was the common parent if the stock was held by another member while the issuer was the common parent.

(i) *Loss stock—(A) Recognized loss.* Any loss recognized, directly or indirectly, by a member with respect to P stock is permanently disallowed and does not reduce earnings and profits. See § 1.1502-32(b)(3)(iii)(A) for a corresponding reduction in the basis of the member's stock.

(B) *Other cases.* If a member, M, owns P stock, the stock is subsequently owned by a nonmember, and

immediately before the stock is owned by the nonmember, M's basis in the share exceeds its fair market value, then to the extent paragraph (f)(6)(i)(A) of this section does not apply, M's basis in the share is reduced to the share's fair market value immediately before the share is held by the nonmember. For example, if M owns shares of P stock with a \$100x basis and M becomes a nonmember at a time when the P shares have a value of \$60x, M's basis in the P shares is reduced to \$60x immediately before M becomes a nonmember. Similarly, if M contributes the P stock to a nonmember in a transaction subject to section 351, M's basis in the shares is reduced to \$60x immediately before the contribution. See § 1.1502-32(b)(3)(iii)(B) for a corresponding reduction in the basis of M's stock.

(ii) *Gain stock.* If a member, M, would otherwise recognize gain on a qualified disposition of P stock, then immediately before the qualified disposition, M is treated as purchasing the P stock from P for fair market value with cash contributed to M by P (or, if necessary, through any intermediate members). A disposition is a qualified disposition only if—

(A) The member acquires the P stock directly from the common parent (P) through a contribution to capital or a transaction qualifying under section 351(a) (or, if necessary, through a series of such transactions involving only members);

(B) Pursuant to a plan, the member transfers the stock immediately to a nonmember that is not related, within the meaning of section 267(b) or 707(b), to any member of the group;

(C) No nonmember receives a substituted basis in the stock within the meaning of section 7701(a)(42);

(D) The P stock is not exchanged for P stock;

(E) P neither becomes nor ceases to be the common parent as part of, or in contemplation of, the plan or disposition; and

(F) M neither becomes nor ceases to be a member as part of, or in contemplation of, the plan or disposition.

(iii) *Options, warrants and other rights.* Paragraph (f)(6)(i) of this section applies to options, warrants, forward contracts, or other positions with respect to P stock (including, for example, cash-settled positions). For example, if S purchases (from any party) a warrant on P stock and the warrant lapses, any loss recognized by S is permanently disallowed. Similarly, if S purchases a warrant on P stock and S becomes a nonmember at a time when the value of the warrant is less than S's

basis in the warrant, S's basis in the warrant is reduced to its fair market value immediately before S becomes a nonmember.

(iv) *Effective date.* This paragraph (f)(6) applies to transactions on or after July 12, 1995 (notwithstanding whether the intercompany transaction, if any, occurred prior to that date).

**Michael P. Dolan,**

*Acting Commissioner of Internal Revenue.*

Approved: June 29, 1995.

**Leslie Samuels,**

*Assistant Secretary of the Treasury.*

[FR Doc. 95-16972 Filed 7-12-95; 12:56 pm]

BILLING CODE 4830-01-U

## 26 CFR Parts 1 and 602

[TD 8597]

RIN 1545-AT58

### Consolidated Groups and Controlled Groups—Intercompany Transactions and Related Rules

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations.

**SUMMARY:** This document contains final regulations amending the intercompany transaction system of the consolidated return regulations. The final regulations also revise the regulations under section 267(f), limiting losses and deductions from transactions between members of a controlled group. Amendments to other related regulations are also included in this document.

**DATES:** These regulations are effective July 18, 1995.

For dates of applicability, see the **EFFECTIVE DATES** section under the **SUPPLEMENTARY INFORMATION** portion of the preamble and the effective date provisions of the new or revised regulations.

#### FOR FURTHER INFORMATION CONTACT:

Concerning the regulations relating to consolidated groups generally, Roy Hirschhorn of the Office of Assistant Chief Counsel (Corporate), (202) 622-7770; concerning stock and obligations of members of consolidated groups, Victor Penico of the Office of Assistant Chief Counsel (Corporate), (202) 622-7750; concerning insurance issues, Gary Geisler of the Office of Assistant Chief Counsel (Financial Institutions and Products), (202) 622-3970; concerning international issues, Philip Tretiak of the Office of Associate Chief Counsel (International), (202) 622-3860; and concerning controlled groups, Martin Scully, Jr. of the Office of Assistant Chief Counsel (Income Tax and

Accounting), (202) 622-4960. (These numbers are not toll-free numbers.)

#### SUPPLEMENTARY INFORMATION:

##### A. Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act (44 U.S.C. 3504(h)) under control number 1545-1433. The estimated average annual burden per respondent is .5 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, PC:FP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

##### B. Background

This document contains final regulations under section 1502 of the Internal Revenue Code of 1986 (Code) that comprehensively revise the intercompany transaction system of the consolidated return regulations. Amendments are also made to related regulations, including the regulations under section 267(f), which apply to transactions between members of a controlled group.

The proposed regulations were published in the **Federal Register** on April 15, 1994 (59 FR 18011). The notice of hearing on the proposed regulations, Notice 94-49, 1994-1 C.B. 358, 59 FR 18048, contains an extensive discussion of the issues considered in developing the proposed regulations. The IRS received many comments on the proposed regulations and held public hearings on May 4, 1994 and August 8, 1994.

After consideration of the comments and the statements made at the hearings, the proposed regulations are adopted as revised by this Treasury decision. The principal comments and revisions are discussed below. However, a number of other changes have been made to the proposed regulations. References in the preamble to P, S, and B are references to the common parent, the selling member, and the buying member, respectively. No inference is intended as to the operation of the prior regulations or other rules.